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SIPDIS

DEPT FOR EAP/MTS AND EB/IFD/OMA
DEPT FOR EAP/IET, OES/IET, AND OES/ETC
DEPT FOR EB/ESC/IEC
DEPT PASS OPIC, EXIM, TDA
DOE FOR CUTLER/PI-32 AND NAKANO/PI-42
TREASURY FOR IA-JEWELL
COMMERCE FOR 4430-GOLIKE
DEPARTMENT PASS FEDERAL RESERVE SAN FRANCISCO

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SUBJECT: INDONESIA - ECONOMIC AND ESTH HIGHLIGHTS - DECEMBER 2005

11. Summary. Indonesian financial markets reacted favorably to a December 6, 2005 cabinet reshuffle, with the rupiah gaining two percent through the end of December to close at 9,840/USD. The Jakarta Stock Exchange composite index also rose six percent after the reshuffle to close at 1,162 on December 29. Indonesia's year-on-year (YoY) consumer price inflation rate fell in December 2005 for the first time in seven months after state oil company Pertamina cut fuel costs and food prices stabilized. Indonesia's non-oil and gas exports increased 18.3 percent in the first eleven months of 2005 compared to the same period in 2004, with machinery/electrical tools, fats and palm oils, and coal as leading export categories. As part of its debt re-profiling efforts, on December 8 the Government of Indonesia (GOI) swapped USD 579 million worth of high yield bonds maturing in 2007-9 with bonds maturing in 2020. The Ministry of Trade announced on December 27 that the GOI would extend a shrimp import ban initially scheduled to expire on December 28, 2005. Coordinating Minister for the Economy Boediono agreed on December 21 to implement a five percent tax on all coal exports. State power company PLN signed an MOU with Korea's KEPCO on December 13 to conduct a nuclear power feasibility study. On December 16, the Indonesian energy firm EMP Kangean signed four gas sales agreements with PLN, state oil company Pertamina, state gas company PGN and private Indonesian gas supplier Indogas Kriya Dwiguna. In the wake of three rounds of national immunizations, new polio cases in Indonesian have fallen from an average of 10 a month from April to August to an average of two per month from October to December. On December 20, State Minister of Environment Rachmat Witoelar announced that the GOI would provide USD 11 million in "Special Allocation Funds" (DAK) for 330 regencies and cities for environmental programs. During the December 12-14 ASEAN Business Forum, President Susilo Bambang Yudhoyono and Russian President Vladimir Putin agreed to develop a commercial satellite launch facility in Biak, Papua. The Indonesian subsidiary of the U.S. company Sara Lee announced on December 19 that it would move production of its well-known Kiwi brand shoe polish from France to Indonesia to reduce labor costs. End Summary.

Markets Strengthen after Cabinet Reshuffle

12. The Indonesian rupiah strengthened in December following a December 5 cabinet reshuffle that included the appointment of former Finance Minister Boediono as the new Coordinating Minister for the Economy and the promotion of State Minister for National Development Planning Sri Mulyani Indrawati to the Finance Ministry. Analysts said the rupiah benefited from capital inflows into the bond and stock markets following the appointment of the two well-respected technocrats. From December 6-30, the rupiah strengthened by 2 percent to close at Rp 9,840/USD on December 29. Jakarta's benchmark stock index rallied strongly in the wake of the reshuffle, rising 6 percent from December to the end of the year, closing at 1,162 on December 29.

Inflation Down Slightly In December

13. Indonesia's inflation rate fell in December for the first time in seven months after the state oil company Pertamina cut fuel costs and food prices stabilized. The Central Bureau of Statistics (BPS) announced on January 2 that consumer prices fell 0.04 percent month-on-month (MoM) in December, with the YoY increase remaining at a very high 17.1 percent. Food prices showed the greatest MoM decline. On December 6, Bank Indonesia (BI) raised the target rate for the benchmark 1-month SBI by 50 bps to 12.75 percent in a move to dampen inflationary pressures. The hike was smaller than many analysts expected, prompting speculation that BI may opt for smaller but more frequent rate increases. BI Governor Burhanuddin Abdullah said on December 6 that BI would likely maintain a tight monetary

policy bias until 2007.

Table 1: Inflation Components - December 2005

Component	MoM	YoY
Foodstuffs	-1.34	13.91
Prepared food, beverages, Tobacco	0.64	13.71
Housing, water, electric, fuel	0.35	13.94
Clothing	0.80	6.92
Health	0.59	6.13
Education, recreation/sports	-0.02	8.24
Transportation, communication and financial services	0.04	44.75
Total	-0.04	17.11

Source: Central Bureau of Statistics (BPS)

Export Growth Continues

14. The Central Statistics Office (BPS) announced on January 2 that Indonesia's exports reached USD 77.3 billion for the first eleven months of 2005, a YoY increase of 19 percent. Non-oil and gas exports accounted for USD 59.9 billion of the eleven-month total, a YoY increase of 18.3 percent. Meanwhile, January-November 2005 imports grew to USD 52.7 billion, a 26.8 percent increase YoY. Overall, Indonesia's trade surplus reached USD 24.1 billion for the first 11 months of 2005, a 5.1 percent increase YoY.

Table 2: Indonesian Trade Performance:
January to November 2005 (in USD billions)

	Jan-Nov 2004	Jan-Nov 2005	Percent Increase 2005/2004
Exports	64.96	77.29	18.98
Oil and Gas	14.30	17.38	21.53
Non-oil and Gas	50.65	59.90	18.26
Agricultural	2.26	2.83	25.12
Industrial	44.36	49.99	12.70
Mining and others	4.03	7.08	75.53
Imports	41.55	52.69	26.80
Oil and Gas	10.53	16.07	52.59
Non-oil and Gas	31.02	36.61	18.04
Balance of Trade	23.41	24.60	5.08

Imports by Broad Economic Categories:

Imports			
Consumption Goods	3.40	4.24	24.66
Raw Materials	32.40	40.94	26.34
Capital Goods	5.74	7.50	30.65

Source: Central Bureau of Statistics (BPS)

15. Industrial exports, which account for 64.7 percent of total exports, expanded 12.7 percent YoY to USD 50 billion from January through November. Machinery/electrical tools, fats and palm oils, and coal, were Indonesia's top three non-oil and gas exports for the period, comprising 11.1, 7.4 and 6.8 percent respectively. Japan edged out the United States as Indonesia's largest non-oil and gas export destination for January-November 2005, followed by Singapore.

Table 3: Indonesia's Top 10 Non-oil and Gas Exports
January to November 2005 (In USD billions)

Commodity	Jan-Nov 2004	Jan-Nov 2005	Percent of Total Jan-Nov 05
Machinery/Electrical Tools	6.08	6.66	11.14
Fats and Palm Oils	3.99	4.40	7.36
Coal	2.56	4.17	6.78
Rubber and Rubber Products	2.73	3.14	5.26
Copper, Ash and Residues	1.52	2.97	4.96
Garment - not Knitted	2.57	2.77	4.63
Furniture, home lightings	1.52	1.71	2.86
Knitted products	1.35	1.65	2.76
Paper pulp	0.56	0.79	1.32
Coffee, tea, spices	0.51	0.70	1.18

Total	23.42	28.96	48.36
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Table 4: Indonesia: Main Non-Oil and Gas Export Destinations, January to November 2005
FOB value, in USD billions)

Country of Destination	Jan-Nov 2004	Jan-Nov 2005	Percent of Total (2005)
Japan	7.61	8.71	14.54
U.S.A.	7.53	8.58	14.32
Singapore	4.88	6.40	10.69
China	3.14	3.57	5.96
Malaysia	2.61	3.01	5.03
South Korea	1.68	2.22	3.70
European Union	8.08	9.19	15.35
Taiwan	1.37	1.63	2.72
Australia	1.08	1.02	1.71
Others	23.42	28.96	48.36
Total	50.65	59.90	100.00

Source: Central Bureau of Statistics (BPS)

Government Swaps High-Yield Bonds

16. On December 12, the Ministry of Finance (MOF) took advantage of renewed foreign investor interest in rupiah bonds by swapping Rp 5.7 trillion (USD 579 million) of bonds maturing in 2007-9 and yielding 10-14 percent into 15-year bonds yielding 14.5 percent. The MOF has been gradually reprofiling its bond portfolio since 2002 through buybacks and swaps for longer duration bonds. Twenty eight percent of Indonesia's Rp 400 trillion (USD 40 billion) rupiah bond portfolio matures between 2007 and 2009. Under a similar program in 2002, the MOF extended by about 10 years the maturity of Rp 170 trillion (USD 17 billion) in bonds, a third of outstanding domestic government debt at that time. Unlike the 2002 reprofiling, done on a bilateral basis with mostly state banks, the MOF conducted the December 2005 through the market.

GOI Extends Shrimp Import Ban

17. Ministry of Trade (MOT) Director General for International Trade Diah Maulida announced on December 27 that the GOI would extend a shrimp import ban initially scheduled to expire on December 28, 2005. The Ministry announced the decision was made following a December 26 meeting between the Ministry of Trade, the Ministry of Marine Affairs and Fisheries (MMAF) and Marine Affairs and stakeholders in Jakarta. on December 26. The GOI MOT first instituted the shrimp import ban on December 28, 2004 to prevent contaminated shrimp and shrimp disease from entering into Indonesia. The MOT later renewed the ban was later renewed on January 26, 2005 and specifically limited its

application to three species of shrimp: frozen and non-frozen shrimp of the vaname, monodon, and stylirostris species (HS codes 0306.13.00.00, 0306.23, and 0306.23.30.00). Press reports suggested that the move was part of a GOI government effort to combat rampant shrimp transshipments through Indonesia to the United States.

GOI Implements Coal Export Tax

18. Coordinating Minister for the Economy Boediono agreed on December 21 to implement Ministry of Finance Decree No.95/2005 on a coal export tax. Under the decree, the GOI will subject all coal exports to a five percent tax (on an ad valorem basis) regardless of export price. Boediono also recommended that the MOF implement the coal export tax in combination with an accelerated VAT reimbursement program. The Indonesian Coal Mining Association (ICMA) expressed disappointment with the decision but said that it would not influence its 2006 production target of 175 million tons. The ICMA foresees continued strong demand next year with prices ranging between USD 45 to 50 per ton.

Indonesia's First Nuclear Power Plant?

19. State electricity company PLN signed a Memorandum of Understanding (MOU) on December 13 with Korea Electric Power Corporation (KEPCO) and Korea Hydro and Nuclear Power Co. (KHNP) to conduct a feasibility study for a nuclear power plant in Indonesia. The study will assess the cost, location, licensing and security for a 1000 megawatt nuclear plant. The National Nuclear Energy Agency (BATAN) conducted its own feasibility study of nuclear plant sites in 2000-

2005 and determined possible plant locations near Java's five major cities (Jakarta, Surabaya, Bandung, Jogjakarta, and Semarang). Indonesia's National Energy Blueprint calls for the inauguration of nuclear power generation by 2017 and sets the goal of deriving almost 2 percent of Indonesia's energy from nuclear sources by 2025. Separately, Minister of Energy and Mineral Resources Purnomo Yusgiantoro visited France earlier in the month to observe operations at the Penly nuclear facility.

Gas Supply Contract Signing

10. EMP Kangean Ltd., a subsidiary of the Indonesian oil and gas firm Energi Mega Persada (EMP), signed Gas Sales Agreements with PLN, Pertamina, state gas company PGN, and the private Indonesian gas supplier PT Indogas Kriya Dwiguna on December 16. The total contract volumes are 642.3 trillion British Thermal Units (BTU) over a 2 to 16 year period with a combined value reportedly worth at least USD 1.9 billion. EMP Kangean Ltd. Operates the Kangean block offshore East Java. Once at full production in late 2007, the block will supply the East Java market, including PLN's Gresik and Grati power plants.

Table 5: EMP Gas Sales Agreements

Buyers	Volume (TBTU)	Price (USD/MMBTU)	Contract Year	Value (USD million)	Start Date
PGN	8.2	2.8	2	17	2006
Pertamina	220.8	2.8	10	627	2008
PLN	342.2	2.9	16	1,070	2008
Indogas Kriya Dwiguna	71.1	2.9	10	230	2008

Source: Various media reports

Polio Infection Rates Decline

11. The incidence of polio infections in Indonesia declined noticeably since the first case in April 2005, following three rounds of National Immunization Days (NID). The number of new polio cases fell sharply, from an average of 10 per month in the April-August time period to an average of two per month from October to December. The two new cases in December occurred in Tanggamus, Lampung, and Sumenep, East Java. The MOH reported no new cases in West Java and Banten provinces, both of which had been the sites of significant outbreaks in April and May 2005. The Ministry of Health (MOH) reported in December that there were 295 cases of polio from April to December 2005 in 10 provinces: Banten (161), West Java (59), Lampung (25), Central Java (20), North Sumatra (10), South Sumatra (5), East Java (5), Jakarta (4), Aceh (3), and Riau (3). The latest onset was on November 10, 2005.

12. Many observers consider the third NID on November 30, 2005 a success since they reached an estimated 98 percent of targeted children (those under five years old). However, there were low vaccination rates in the remote provinces of Papua (50.3 percent of 144,000 targeted children), West Irian (73.8 percent of 65,000), and North Maluku (86.4 percent of 84,000). Nonetheless, there have been no reports so far of polio cases in these areas. Minister of Health Siti Fadilah Supari explained December 16 that the MOH finds it difficult to access these remote areas due to a lack of funding for transportation. The GOI plans to hold an immunization mop up on January 30th in the Provinces of Banten, East Java, Lampung, North Sumatra, and South Sumatra. In addition, at the WHO's urging, the GOI plans a fourth NID for February 27, 2006. A fifth NID has been proposed for April 2006, but the MOH has not yet confirmed it.

13. President Director of PT Bio Farma Marzuki Abdullah said that in line with a World Health Organization (WHO) recommendation, the MOH used monovalen vaccines in polio endemic areas in the third round. Endemic areas include the island of Java, and Lampung and South Sumatra provinces. PT Bio Farma provided 19.8 million doses of monovalen polio vaccines for the third round.

GOI Launches Environment Fund for Regions

14. On December 20, State Minister of Environment Rachmat Witoelar announced that for the first time, the GOI would provide "Special Allocation Funds" (DAK) in the 2006 budget to help selected local governments in 30 provinces conserve their natural resources and implement environmental programs. Witoelar said the Ministry of Finance would allocate a total of Rp 112.5 billion (USD 11.2 million) in

2006, and would distribute the funds to 330 cities and regencies that allocate less than Rp 50 million (USD 5,100) each for the environment. The funds are intended to enhance the capacity of cities and regencies to implement sustainable development principles.

15. Ministry of Environment Executive Secretary Arief Yuwono explained that in FY 2006, the MOE would prioritize improving river water quality. Each of the eligible cities or regencies would receive between Rp 300 million (USD 30,000) and Rp 1.7 billion (USD 173,000) for the restoration and monitoring of rivers. Yuwono noted that around 100 municipalities and three provinces (Jakarta, Riau, and East Kalimantan) would not receive any funds since they have sufficient funds for environmental management. Some observers stated that they believe the amount of the funds is inadequate for rehabilitating the significant percentage of Indonesia's rivers considered heavily polluted (as much as 89 percent according to one environmental NGO). The environmental funds represent only one percent of the Rp 10 trillion (USD 1 billion) Special Allocation Funds designated for education, agriculture, health, maritime, fisheries, and infrastructure construction in FY 2006. According to press

reports, the MOF disbursed the funds on January 2, 2006.

Indonesian-Russian Satellite Launch Facility

16. President Susilo Bambang Yudhoyono and Russian President Vladimir Putin reportedly agreed to develop a satellite and commercial rocket launch services facility in Biak, Papua, during a meeting on the margins of the December 12-14 ASEAN Business Forum in Kuala Lumpur. The two presidents agreed to sign an MOU in January 2006 calling for a first satellite launch in 2007 and establishing a joint venture to operate the launch facility. Director of Central and East Europe at the Ministry of Foreign Affairs, Hazairin Pohan, told the press that Indonesia and Russia plan to locate the launch facility at Frans Kaisiepo Airport in Biak. Pohan estimated the project would cost USD 120-130 million. During two meetings in 2003, the Indonesian National Institute of Aeronautic and Space (LAPAN) and the Russian Federal Space Agency (RFSA) agreed to accelerate technology cooperation and signed a Memorandum of Intent for technology cooperation.

LAPAN is inter-departmental coordinator for the project had been working to prepare supporting regulations. RFSA will appoint ALAC and Indonesia (LAPAN and Ministry of Foreign Affairs) will appoint one local partner company for project. Sara Lee to Relocate Business to Indonesia

17. Sara Lee Indonesia President Director Amitava Chatterjee announced on December 19 that his company will expand production of its well-known Kiwi brand shoe polish from France to Indonesia to reduce labor costs. Chatterjee said Sara Lee Corporation, a U.S. based company, would also relocate operations to China and India. Sara Lee Indonesia currently exports 20 percent of the Kiwi shoe polish it produces. Chatterjee said he expects that figure will rise to 50 percent following the production expansion.

Table 6: Selected Economic, Financial, and Trade Statistics, September-December 2005

	Sep	Oct	Nov	Dec
CPI inflation (YoY)	9.06	17.89	18.38	17.11
CPI inflation (MoM)	0.69	8.70	1.31	-0.04
Exchange rate (Rp/USD)(1)	10,290	10,090	10,035	9,840
30-day SBI rate (1)	10.00	11.00	12.25	12.75
Foreign Res. (USD bn)(1)	31.2	32.5	33.2	34.1
JSX Composite Index(1)	1079.3	1066.2	1096.6	1162.6
JSX Daily Av. (mn shares)	1,285	1,260	878	
Exports (USD billion)	7.38	7.76	6.83	
Percent change (YoY)	21.15	19.51	18.98	
Imports (USD billion)	4.90	4.79	4.04	
Percent change (YoY)	30.59	29.13	26.80	
Trade Balance	2.48	2.97	2.79	

Source: Bank Indonesia, BPS, JSX

(1) End of period

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